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DEPARTMENT OF AGRICULTURE

Rural Housing Service

7 CFR Part 3555

RIN 0575-AD10

Single Family Housing Guaranteed Loan Program

AGENCY: Rural Housing Service, USDA.

ACTION: Final rule.

SUMMARY: The Rural Housing Service (RHS or Agency) published a proposed rule on June 20, 2018 to amend the current regulation for the Single-Family Housing Guaranteed Loan Program (SFHGLP) Single Close Combination Construction to Permanent Loans (aka "single close loans"), and now adopts the proposed changes in this final rule with some modifications. As proposed, the Agency will amend the regulation to ease the financial costs of interim construction financing for non-depository lenders (warehouse line of credit lenders or warehouse lenders) by allowing a temporary interest rate higher than the permanent note rate for interim construction financing, remove the requirement for loan modification or re-amortization once construction is complete, and allow for the reserve of regularly scheduled principal, interest, taxes and insurance (PITI) payments during the construction

period. The final rule clarifies that the PITI reserve is an eligible use of single close loan funds. In addition, based on comments received, the Agency will allow single close loans for the rehabilitation of existing dwellings upon their purchase and eliminate maximum interest rate cap requirements for all SFHGLP loans. For clarity and completeness, the final rule also provides a definition of a warehouse lender and updates lender mortgage record retention requirements.

DATES: Effective on [**INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER.**]

FOR FURTHER INFORMATION CONTACT: Kate Jensen, Finance and Loan Analyst, Single Family Housing Guaranteed Loan Division, STOP 0784, Room 2250, USDA Rural Development, South Agriculture Building, 1400 Independence Avenue SW., Washington, DC 20250-0784, telephone: (503) 894-2382, email is kate.jensen@usda.gov.

SUPPLEMENTARY INFORMATION:

Executive Order 12866, Classification

This rule has been determined to be non-significant and therefore was not reviewed by the Office of Management and Budget (OMB) under Executive Order 12866.

Executive Order 12988, Civil Justice Reform

This final rule has been reviewed under Executive Order 12988, Civil Justice Reform. Except where specified, all State and local laws and regulations that are in direct conflict with this rule will be preempted. Federal funds carry Federal requirements. No person is required to apply for funding under SFHGLP, but if they do apply and are selected for funding, they must comply with the requirements applicable to the Federal program funds. This final rule is not retroactive. It will not affect agreements entered into prior to the effective date of the rule. Before any judicial action may be brought regarding the provisions of this rule, the administrative appeal provisions of 7 CFR part 11 must be exhausted.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104-4, establishes requirements for Federal agencies to assess the effect of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, the Agency generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million, or more, in any one

year. When such a statement is needed for a rule, section 205 of the UMRA generally requires the Agency to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, most cost-effective, or least burdensome alternative that achieves the objectives of the rule.

This final rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

Environmental Impact Statement

This document has been reviewed in accordance with 7 CFR part 1970, subpart A, "Environmental Programs." It is the determination of the Agency that this action does not constitute a major Federal action significantly affecting the quality of the human environment, and, in accordance with the National Environmental Policy Act of 1969, Pub. L. 91-190, neither an Environmental Assessment nor an Environmental Impact Statement is required.

Executive Order 13132, Federalism

The policies contained in this rule do not have any substantial direct effect on States, on the relationship between the national government and States, or on the

distribution of power and responsibilities among the various levels of government. Nor does this rule impose substantial direct compliance costs on State and local governments. Therefore, consultation with the States is not required.

Regulatory Flexibility Act

In compliance with the Regulatory Flexibility Act (5 U.S.C. 601 et seq.) the undersigned has determined and certified by signature of this document that this rule change will not have a significant impact on a substantial number of small entities. This rule does not impose any significant new requirements on Agency applicants and borrowers, and the regulatory changes affect only Agency determination of program benefits for guarantees of loans made to individuals.

Executive Order 13175, Consultation and Coordination with Indian Tribal Governments

Executive Order 13175 imposes requirements on RHS in the development of regulatory policies that have Tribal implications or preempt tribal laws. RHS has determined that the final rule does not have a substantial direct effect on one or more Indian Tribe(s) or on either the relationship or the distribution of powers and responsibilities between the Federal Government and Indian

Tribes. Thus, this final rule is not subject to the requirements of Executive Order 13175. If a Tribe determines that this rule has implications of which RHS is not aware and would like to engage with RHS on this rule, please contact USDA's Native American Coordinator at (720) 544-2911 or AIAN@usda.gov.

Executive Order 12372, Intergovernmental Review of Federal Programs

These loans are subject to the provisions of Executive Order 12372, which require intergovernmental consultation with State and local officials. RHS conducts intergovernmental consultations for each SFHGLP loan in accordance with 2 CFR part 415, subpart C.

Programs Affected

The program affected by this regulation is listed in the Catalog of Federal Domestic Assistance under Number 10.410, Very Low to Moderate Income Housing Loans (Section 502 Rural Housing Loans).

Paperwork Reduction Act

The information collection and record keeping requirements contained in this regulation have been approved by OMB in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The assigned OMB control number is 0570-0179.

E-Government Act Compliance

The Agency is committed to complying with the E-Government Act, to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

Non-Discrimination Policy

In accordance with Federal civil rights law and U.S. Department of Agriculture (USDA) civil rights regulations and policies, the USDA, its Agencies, offices, and employees, and institutions participating in or administering USDA programs are prohibited from discriminating based on race, color, national origin, religion, sex, gender identity (including gender expression), sexual orientation, disability, age, marital status, family/parental status, income derived from a public assistance program, political beliefs, or reprisal or retaliation for prior civil rights activity, in any program or activity conducted or funded by USDA (not all bases apply to all programs). Remedies and complaint filing deadlines vary by program or incident.

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etc.) should contact the responsible Agency or USDA's TARGET Center at (202) 720-2600 (voice and TTY) or contact USDA through the Federal Relay Service at (800) 877-8339. Additionally, program information may be made available in languages other than English.

To file a program discrimination complaint, complete the USDA Program Discrimination Complaint Form, AD-3027, found online at http://www.ascr.usda.gov/complaint_filing_cust.html and at any USDA office or write a letter addressed to USDA and provide in the letter all of the information requested in the form. To request a copy of the complaint form, call (866) 632-9992. Submit your completed form or letter to USDA by:

(1) Mail: U.S. Department of Agriculture
Office of the Assistant Secretary for
Civil Rights

1400 Independence Avenue, SW.,
Washington, D.C. 20250-9410;

(2) Fax: (202) 690-7442; or

(3) E-mail: program.intake@usda.gov.

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Background Information

The Agency is amending its regulations to provide increased flexibility in loan terms to facilitate and encourage single close loans, which will stimulate new construction, rehabilitation, and homeownership in rural areas. Currently, warehouse lenders have considerable difficulty making affordable guaranteed single close loans because of the inability to cover construction costs and make payments to secondary market investors during the construction period. The proposed rule (83 FR 28547) sought to address these challenges through the following:

- Allow warehouse lenders the flexibility to charge a temporary and higher interest rate to cover their line of credit costs during construction as an eligible loan purpose. The temporary higher interest rate for the single close loan program would be limited to the construction period and must revert to the underlying promissory note rate or lower for the balance of the loan.

- Permit all lenders to create a reserve account for a up to 12 months of a borrower's regularly scheduled PITI payments from the original loan closing to make the loan payments during the construction period. This would make the process more affordable to the borrower who will not have to make both their existing housing payment and

the construction loan payment at the same time during construction. While this change is available to all lenders, it will be predominantly utilized by those lenders who immediately securitize a loan after loan closing. The PITI reserve is intended solely for the use of making the borrower's fully amortized PITI payment during the construction period. The PITI reserve cannot be combined with any other reserve account and should any funds remain in the PITI reserve after construction is complete the lender is required to apply the excess funds as a principal payment.

- Remove the requirement for a loan modification or re-amortization at the end of the construction period, allowing loans to remain in mortgage backed securities without interruption.

In addition to adopting the proposed changes above, the final rule also makes several other changes based on comments received in response to the proposed rule. First, single close loan purposes will include rehabilitation when the property being purchased requires rehabilitation to meet program standards. Second, the final rule adds the definition of a warehouse lender. Third, the final rule updates lender mortgage record retention requirements to include single close construction documentation. Lastly,

the final rule will update the regulation to eliminate the maximum interest rate cap for all SFHGLP loans to allow lenders the increased ability to extend credit to eligible applicants. This change is based on comments received in response to the proposed rule as well as the Request for Information (RFI) on August 17, 2018 (83 FR 41056) reduction or elimination of the interest rate cap.

These actions are taken to provide low- and moderate-income households in rural areas greater opportunities to acquire affordable newly constructed homes or rehabilitate an existing home, provide greater cost efficiency during construction, and increase viability in the secondary mortgage markets. These changes will expand affordable housing opportunities for rural borrowers and local builders as well as the economic viability of rural communities. Each change and Agency response to any comments to the proposed rule is discussed below. Topics are addressed below in order of appearance in the regulation, not based in order of predominance.

§3555.104 Loan Terms

Nine respondents fully supported the Agency's proposal to add provisions allowing an increased interest rate for interim construction financing during the construction period. This provision will increase participation in the

single close loan program by lenders who utilize a warehouse line of credit during construction.

One respondent replied unfavorably to the Agency's proposal to allow a higher rate of interest during the construction period, expressing concern that the current interest rate cap should stay in place to ensure customers falling within the lower income brackets have a chance at becoming homeowners. The Agency appreciates the comment; however, if warehouse lenders cannot recover their construction costs, they will not make such loans at all, since the current regulations are too restrictive. The changes do not take away existing loan opportunities from customers—rather, the changes allow single close loans to become available to more borrowers. In addition, lenders must still underwrite loans in accordance with existing regulations and guidance on applicant income, debt ratios, repayment ability, and other aspects that contribute to affordable loans and successful homeownership. Loans are also subject to the disclosure requirements of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA).

Allowing the higher interest rate during the construction period will expand opportunities for warehouse lenders to participate in the SFHGLP increasing competition

in the marketplace. Encouraging new construction increases affordable housing opportunities in rural communities removing barriers to homeownership for low- to moderate-income applicants. The higher interest rate would be for a limited time and amortized on the loan advances, not the entire loan amount, and the interest costs can be included as an eligible loan purpose.

Therefore, the Agency is finalizing the proposal to allow a higher interest rate for warehouse lender interim construction financing accrued during the construction period up to twelve months. The interest rate must revert to a rate that is no higher than the promissory note rate once the construction period has ended. The Agency clarifies in the final rule that the higher interest rate for interim construction financing is only available for loans made by warehouse lenders. In addition, the Agency retains the authority to establish a maximum interest rate in the handbook as necessary to further program goals and protect the best interest of the government.

Two respondents recommended the Agency to raise or remove the maximum interest rate cap program wide for all SFHGLP loans, not just for the single close loans. Both respondents commented that raising or removing the current interest rate cap provides lenders the flexibility to offer

reasonable rates to their clients or participate in a concurrent affordable housing product offered by a Housing Finance Agency (HFA). In response to the RFI which sought opinion regarding the reduction or elimination of the interest rate cap for all SFHGLP loans, most comments were in favor of eliminating the interest rate cap, citing the inability of the HFAs to adequately price the SFHGLP product. The Agency agrees with the comments and will revise section 3555.10 and 3555.104(a)(3) to eliminate the maximum interest rate cap, and instead require approved lenders and borrowers to negotiate the best interest rate in compliance with all applicable laws. The change is also consistent with policies of other federal mortgage credit programs, such as the Department of Veterans Affairs and Department of Housing and Urban Development. All loans must still meet program underwriting requirements and are subject to RESPA and TILA.

§3555.105 Combination Construction and Permanent Loans

Nine respondents fully supported the Agency's proposal to allow a reserve of up to 12 months of the borrower's regularly scheduled PITI payments during the construction period.

The proposed rule used "reserve" and "escrow" interchangeably when discussing this PITI account. Based

on feedback regarding industry standards, the final rule refers to the PITI account as a "reserve", not an "escrow". The PITI reserve is separate from the construction escrow and the two accounts must not be combined.

One respondent supported the regulation changes for the single close option but requested clarification on fair market appraisal value and the appraiser's ability to use the cost approach to determine fair market value. The respondent expressed concern that the inclusion of a reserve account for twelve months PITI payments as an eligible loan cost could potentially increase the loan amount over the fair market appraised value, forcing the borrower to incur out of pocket expenses. The Agency agrees that in some circumstances the home may not appraise for the full value of the dwelling and construction. In such cases, a conditional commitment will not be issued, the loan will not be closed, construction will not be initiated, and the borrower will not incur out of pocket expenses; however, when the appraiser has been fully informed of all the hard and soft costs for the new construction, including any reserves, the homes are more likely to appraise for the complete cost or value of the new construction. No change is made to the provision.

One respondent requested the Agency to allow the use of the cost approach to determine the fair market value of single close construction properties. The respondent believes the appraiser should determine if the cost approach or sales comparison approach will best determine property value. Currently, the Agency considers the sales comparison approach (also referred to as the market value approach) as the principal method for appraisers to determine their opinion of value. However, the Uniform Standards of Professional Appraisal Practices (USPAP) also provide for appraisers to use the cost approach to value. The Agency agrees the cost approach is a useful tool for appraisers to use. While the current regulation can encompass both cost approach and sales comparison approach, the Agency will update §3555.105(d)(2) to reiterate that appraisals must be conducted in accordance with USPAP and clarify in the handbook that either the cost or market value approach is acceptable. No other change is made in this provision.

One respondent requested the Agency to provide clear guidance addressing the collection and financing of the PITI reserve account along with any refund policy for the PITI reserve account should the property sell within twelve months. Typically, a property will not be sold within the

construction period without extenuating circumstances. Under §3555.105(g), in the event of unplanned changes during construction, a lender remains responsible for completion of improvements satisfactory to Rural Development, and that the loan will be serviced in accordance with applicable regulations. As explained in Chapter 12 of Handbook 3555, all available funds in the construction escrow account would be used to complete the project and remaining funds would be applied as a principal reduction. This final rule clarifies such policy in §3555.105(g) and extends the policy to any remaining PITI reserve funds. Therefore, under the final rule, in the event of unplanned changes preventing completion of construction, the lender must complete improvements to the satisfaction of Rural Development and apply any remaining PITI reserve and construction escrow funds (after satisfactory improvements are complete) as a principal reduction. The lender would proceed with loan servicing options as appropriate. The Agency is also amending §3555.105(e) to require mortgage file documentation evidencing the lender's use of any remaining PITI reserve or construction escrow funds for principal reduction.

One respondent requested the Agency to provide additional guidance for the distribution of loan funds

during construction and clarification on whether the lender or servicer will be responsible for the distribution of those funds. It is the responsibility of the lender to pay out monies from escrow to the builder during construction upon written approval from the borrower and to document that the appropriate work was completed in accordance with §3555.105(a)(5). No change is made in this provision.

One respondent supported the changes to the single close loan program but requested the Agency to remove the requirement to conduct individual credit checks on contractors. Section 3555.105(b) does not require individual credit checks on contractors; however, the Agency will clarify the administrative guidance (Handbook 3555 Chapter 12) providing options to determine and document a builder's credit history. No change is made in this provision.

Three respondents fully supported the Agency's proposed amendments to the single close loan program and requested the Agency to extend the program to include rehabilitation loans. The Agency agrees with the comments submitted and will amend the language in §3555.105(c) and §3555.105(e) to include rehabilitation with the purchase of an existing dwelling as an allowable single close loan purpose.

After careful review and consideration of the comments submitted, the Agency decided the addition of rehabilitation in the single close loan program will increase inventory options and expand construction opportunities for rural applicants and lenders. The revisions allow the lender to finance the rehabilitation and purchase of an existing dwelling, to recapture interest accrued on a business line of credit during construction, and to reserve the entire regularly scheduled fully amortized PITI payment for the construction period. Allowable rehabilitation costs are those required to bring the dwelling into compliance with program standards. The need for these types of repairs are typically mentioned in the appraisal or inspection report. Single close loans may not be used to finance standalone rehabilitation without purchase of the dwelling that will be rehabilitated.

Current regulation prohibits the use of single close loans for condominiums. While SFHGLP loans are rarely used for condominiums in general, the Agency will clarify in this final rule that "condominiums" ineligible for single close loans include detached and site condominiums. The clarification is made in response to evolving types of condominiums, all of which are still excluded from single close loan purposes.

The Agency is updating the mortgage file documentation requirements in §3555.105(e) to reflect the addition of rehabilitation as an allowable single close loan purpose.

Overall, the regulatory revisions will reduce the burden of construction financing on small and medium sized lenders, streamline and expand the program, and provide lenders the ability to quickly transfer closed loans to program investors.

List of Subjects in 7 CFR Part 3555

Home improvement, Loan Programs - Housing and community development, Eligible loan purpose, Construction, Loan terms, Mortgages, Rural areas.

Therefore, chapter XXXV, title 7 of the Code of Federal Regulations is amended as follows:

PART 3555 - GUARANTEED RURAL HOUSING PROGRAM

1. The authority citation for Part 3555 continues to read as follows:

Authority: 5 U.S.C. 301; 42 U.S.C. 1471 et seq.

Subpart C - Loan Requirements

2. Amend § 3555.10 by removing the definition of "maximum allowable interest rate" and adding the definition of "warehouse lender" in alphabetical order to read as follows:

§ 3555.10 Definitions and abbreviations.

* * * * *

Warehouse lender. A non-depository lender who utilizes short-term revolving lines of credit to finance loan origination and or construction financing.

3. Amend § 3555.104 by revising paragraphs (a) (2) through (4) to read as follows:

§ 3555.104 Loan terms.

(a) * * *

(2) Shall be negotiated between the lender and the borrower to allow the borrower to obtain the best available rate in compliance with all applicable laws.

(3) If the interest rate increases between the time of the issuance of the conditional commitment and the loan closing, the lender will submit appropriate documentation and underwriting analysis to confirm that the applicant is still eligible.

(4) The warehouse lender may charge an interest rate for interim construction financing that exceeds the underlying promissory note rate. After construction ends, the interest rate must revert to a rate that is no higher than the underlying promissory note rate. The Agency reserves the right to establish a maximum amount for the interim construction financing interest rate in the

handbook, as necessary to further program goals and protect the best interests of the government.

* * * * *

4. Amend § 3555.105 by:

- a. Revising paragraph (c) (1);
- b. Adding paragraph (c) (2) (iv);
- c. Revising paragraph (d) (2);
- d. Adding paragraph (d) (7);
- e. Revising paragraph (e) (1)
- f. Removing "and" from the end of (e) (6);
- g. Revising paragraph (e) (7);
- h. Adding paragraph (e) (8); and
- i. Revising paragraph (g).

The revisions and additions read as follows:

§ 3555.105 Combination construction and permanent loans.

* * * * *

(c) * * *

(1) The loan is to finance the purchase of real estate and construction of a single family dwelling or the purchase and required rehabilitation of an existing single family dwelling. Condominiums, including detached condominiums and site condominiums, are ineligible for combination construction and permanent loans.

(2) * * *

(iv) The costs of an interim construction financing interest rate and PITI reserve under §3555.104(e) and §3555.105(d)(7), respectively.

(d) * * *

(2) The fair market value as determined by a licensed or certified appraiser in accordance with regulation 3555.107(d) will be used to establish the maximum loan amount.

* * * * *

(7) Lenders may fund a reserve account for up to 12 months of regularly scheduled (amortized) principal and interest payments along with taxes and insurance (PITI). In such cases, a loan modification is not required after construction is complete. Funds remaining in the PITI reserve after construction is complete will be applied by the lender as a principal payment.

(e) * * *

(1) The actual cost to construct or rehabilitate the subject dwelling.

* * * * *

(7) Loan modification agreement, once construction is complete, confirming the existence of a permanent loan and the amortizing interest rate on the loan; and

(8) Evidence that all funds remaining in the construction escrow or PITI reserve accounts have been applied as a principal curtailment once construction or rehabilitation is complete.

* * * * *

(g) *Unplanned changes during construction.* Should an unplanned change occur with the borrower or contractor preventing completion of construction, the lender remains responsible for completion of improvements satisfactory to Rural Development. The loan will be serviced in accordance with subparts F and G of this part. Funds remaining in all PITI reserve and construction escrow accounts after full disbursement of construction costs will be applied by the lender as a principal payment.

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Bruce W. Lammers
Administrator
Rural Housing Service
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